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Supreme Court of the United States.

OCTOBER TERM, 1940.

No. 38.

HOWARD S. PALMER, JAMES LEE LOOMIS AND HENRY B. SAWYER, TRUSTEES OF THE PROPERTY OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, *Petitioners*,

v.

CONNECTICUT RAILWAY AND LIGHTING COMPANY.

MOTION AND BRIEF OF ROBERT G. DODGE AND TALCOTT M. BANKS, JR., AMICI CURIAE.

ROBERT G. DODGE,
TALCOTT M. BANKS, JR.,
Special Counsel for the Trustees of the Property of Old Colony Railroad Company, as Amici Curiae.

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v.

CONNECTICUT RAILWAY AND LIGHTING COMPANY.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE.

May it Please the Court:

The undersigned, Special Counsel for Howard S. Palmer, James Lee Loomis and Henry B. Sawyer, as Trustees of the Property of Old Colony Railroad Company, respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae*.

ROBERT G. DODGE,
TALCOTT M. BANKS, JR.,
Special Counsel for the TRUSTEES OF THE PROPERTY OF OLD COLONY RAILROAD COMPANY, as *Amici Curiae*.

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v.

CONNECTICUT RAILWAY AND LIGHTING COMPANY.

BRIEF OF ROBERT G. DODGE AND TALCOTT M. BANKS, JR., AMICI CURIAE.

Preliminary Statement.

This brief is filed by Special Counsel for the Trustees of the Property of Old Colony Railroad Company (hereinafter called "Old Colony"), who have a claim against the estate of The New York, New Haven and Hartford Railroad Company (hereinafter called "New Haven") for disaffirmance of a railroad lease with an unexpired term of fifty-six years.

For its bearing on the ques ion of law which the case at bar presents reference is made to *In re New York, New Haven and Hartford Railroad Company,* 30 F. Supp. 541, the decision in the District Court allowing Old Colony's claim for the loss of its lease. While the Old Colony case is

not now before this Court, it is believed that the lower court decision illustrates the proper application of the rule prescribed by this Court in *Connecticut Railway and Lighting Company* v. *Palmer*, 305 U.S. 493, 504, that the lessor's damages should be measured by

> ". . . the present value of the rent reserved less the present rental value of the remainder of the term."

In the decision referred to the District Judge found upon ample and uncontroverted evidence that the remainder of the term was without any "present rental value" whatever, and he therefore awarded as damages "the present value of the rent reserved."

The Circuit Court of Appeals in the case at bar has followed a different principle. It has awarded the claimant in effect an allowance based on a residual term of 11 years, when the lease actually had, at disaffirmance, 969 years to run. While the full scope of this ruling is not wholly clear, it appears to assume that making a reasonable valuation of a long term is legally impossible. Further, it seems to regard the process of valuation primarily as one of adding up assumed values for each future year to the furthest point where a court may risk prediction. In both these respects, it is contended, the Circuit Court of Appeals erroneously interpreted and applied the controlling decision of this Court.

Argument.

It is submitted that there is no rule of law which makes it impossible under Section 77 of the Bankruptcy Act to evaluate a long unexpired term, or to award the lessor of a disaffirmed lease damages for the full loss suffered if established as in the case of *In re New York, New Haven and Hartford Railroad Company*, 30 F. Supp. 541.

I. The Formula for the Measure of Damages.

In *Connecticut Railway and Lighting Company* v. *Palmer* this Court stated the rule by which damages are computed:

> ". . . the present value of the rent reserved less the present rental value of the remainder of the term."[1]

This formula has been frequently approved by this Court,[2] and its use is universal where damages for loss of a lease are allowed to a landlord.[3]

The difference between the discounted rents reserved and the present rental value of the premises for the period in issue is an exact and literal measure of the value of any specific term for years. If the rent reserved exceeds the present rental value, then rent-less-rental value states the worth of the lease to the landlord; whereas if the situation is the other way, and the term is worth more than the rent reserved, rental value-less-rent measures the value of the lease to the lessee. This method of measuring is therefore employed wherever the value of a term, or part of a term, to either lessor or lessee is to be determined, as in tax cases,[4] cases of eminent domain [5] and cases involving unlawful termination of a lease by the lessor [6] or breach of a contract to

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[1] 305 U.S. 493, 504.

[2] *Wm. Filene's Sons Co.* v. *Weed*, 245 U.S. 597, 602; *Irving Trust Co.* v. *Perry Co.*, 293 U.S. 307, 311; *City Bank Farmers Trust Co.* v. *Irving Trust Co.*, 299 U.S. 433, 443; *Kuehner* v. *Irving Trust Co.*, 299 U.S. 445, 450.

[3] This is true in England and the United States; see *Connecticut Railway and Lighting Co.* v. *Palmer*, 305 U.S. 493, 504, and cases cited at p. 504, notes 21 and 23.

[4] *Appeal of Secor Hotel Company*, 7 B.T.A. 158, 162; *Plumb* v. *Commissioner*, 7 B.T.A. 295, 298. See also pages 7-9, *infra*.

[5] *Carlock* v. *United States*, 53 F. (2d) 926, 927-928 (Ct. App., D.C.); *Corrigan* v. *City of Chicago*, 144 Ill. 537, 548-549. See also pages 10-11, *infra*.

[6] *King* v. *King*, 83 Wash. 615, 620; *Cannon* v. *Wilbur*, 30 Neb. 777, 782. See also page 12, *infra*.

take, or give, a lease.[7] There is, indeed, no other adequate method for appraising the fair value of a term, or for computing the damages suffered when a term is destroyed.

II. The Valuation of Long-Term Leases.

The long-term lease has been familiar for centuries in English law.[8] Its general adoption in this country has been relatively slow, but in the past half century its usefulness has been increasingly recognized. It has become one of the chief instruments for financing urban office building construction in large cities and has played a prominent part in the construction of the nation's systems of railroads.[9] In railroad finance the lease has been favored particularly because it permitted acquisition of a line without the great initial expense involved in outright purchase, and the value of the railroad properties which Class I railroads have under

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[7] *Oldfield* v. *Angeles Brewing & Malting Co.*, 62 Wash. 260, 263. Williston on Contracts (Revised ed.) section 1405. See also pages 11-12, *infra*.

[8] See McMichael, Long and Short Term Leaseholds (3d ed., 1925) chapter I. *The Long Term Ground Lease: A Survey* (1939) 48 Yale L.J. 1400.

[9] Almost half the business district in Chicago is built upon land subject to long-term leases. Over 240 such leases, covering many important properties, were recorded in Detroit in the period 1900-1929. In New York buildings such as Rockefeller Centre, the Chrysler Building, the Waldorf-Astoria and Commodore Hotels and Wanamaker's Store are held under long-term leases. *Bowman Hotel Corp.* v. *Commissioner*, 24 B.T.A. 1193. *The Long Term Ground Lease: A Survey* (1939) 48 Yale L.J. 1400, notes 1-2. Fisher and Neihuss, *Catalog of Long-Term Leases in Detroit* (1929) 2 Mich. Bus. Studies, Pamphlet 5. Fisher and Neihuss, *Problems of Long-Term Leases, id.*, Pamphlet 8. For railroad leases, see Meck and Masten, *Railroad Leases and Reorganization* (1940), 49 Yale L.J. 626.

lease has been recently estimated as approximately four and one-half billion dollars.[10]

No reason appears why the value of a long-term leasehold cannot be determined under Section 77 of the Bankruptcy Act as well as it can be in a tax case, or a condemnation case, or an action of contract. In these classes of cases the task has been undertaken in any number of different sets of circumstances.

A. Tax Cases.

There are many instances where long-term leases must be valued for tax purposes, and the courts have shown no hesitation in requiring such valuation or in approving values arrived at on a basis of substantial evidence.

Findings of the values of leaseholds expiring in 1985, made for the purpose of calculating a tax on gains from sales, were approved by the court in *Friend* v. *Commissioner*, 102 F. (2d) 153 (C.C.A. 7).

In *People ex rel. Delaware & Hudson Canal Co.* v. *Feitner*, 61 App. Div. 129 (affirmed on the opinion below, 171 N.Y. 641), the court ordered a reassessment of the "actual value" of two railroad leases, having respectively about 100 and 500 years to run, for the purpose of calculating a capital stock tax. The same tax was involved in *People ex rel. Metropolitan Street Railway Co.* v. *Barker*, 121 App. Div. 661 (affirmed on the opinion below, 200 N.Y. 509), where the valuation of nine street railway leases[11] was in issue, the court stating (121 App. Div. at p. 663):

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[10] Statistics of Railways in the United States (1938 ed.), Interstate Commerce Commission, p. S-112. The New York Central System alone has more than 30 such leases, ranging from small terminal properties to the 1600 miles of the "Big Four," which was leased in 1930 for a 99-year term. *Idem*, pp. 220-222.

[11] The opinion does not give the terms of these leases, but it is probable that they included the 999-year lease of the Harlem Rail-

". . . But it was the value of these leases to the lessee on the second Monday of January, 1897, that was in controversy, and the defendants were required to fix the actual value of the leases as the property of the relator subject to taxation. The actual value of the leases was to be ascertained, as is the actual value of other property when required to be ascertained in a judicial proceeding."

In the case of *Commonwealth* v. *Delaware, Lackawanna and Western Railroad Company,* 145 Pa. St. 96, the lessee's interest in a perpetual railroad lease [12] was found to have a value of one million dollars, and the taxpayer established this value as an exemption in the computation of the Pennsylvania tax upon its capital stock.

A lessee's interest in a long-term lease may be subject to a property tax, and this presupposes that it can be reasonably valued. Thus the Court of Appeals of Maryland has in two cases required the assessment of lessees' interests held by railroads in property in Baltimore, under 99-year leases renewable forever,[13] the valuation to be made "subject to the rent reserved"—*i.e.,* the rent to be deducted from the rental value.

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road Company, the lease of the "Belt Line" which then had a residual term of 63 years, and other leases for long terms, referred to in the Metropolitan Street Railway Company receivership litigation. See *Pennsylvania Steel Co.* v. *New York City Railway Co.,* 165 Fed. 459; *idem,* 165 Fed. 472, 474; *idem,* 176 Fed. 471, 473.

[12] The terms of this lease from the Warren Railroad to the Lackawanna are summarized in Statistics of Railways in the United States (1938 ed.), Interstate Commerce Commission, at p. 218.

[13] *Appeal Tax Court of Baltimore* v. *Western Md. R.R. Co.,* 50 Md. 274, 298; *Philadelphia, W. & B. R.R. Co.* v. *Appeal Tax Court of Baltimore,* 50 Md. 397, 410, 413. The market value of a 99-year lease, renewable forever, was also assessed for a property tax in *Ocean Grove Camp Meeting* v. *Reeves,* 79 N.J.L. 334, affirmed 80 N.J.L. 464.

The Supreme Court of Washington, approving the reduction of a property tax assessment of a 50-year term, said: [14]

> "In determining the worth of a leasehold the courts have universally held that it is the value of the term less the rent reserved. The value of the term is fixed with reference to present as well as prospective conditions . . ."

Additional cases of the valuation of long-term leaseholds are found in connection with a mortgage tax,[15] the determination of a proper basis of invested capital under the Federal income tax laws,[16] and, under the same laws, the fixing of an allowance for depreciation or exhaustion of a leasehold by which the taxpayer, if successful in proving that the leasehold has a definite value, may reduce his annual tax assessment.[17]

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[14] *Metropolitan Building Co.* v. *King County,* 62 Wash. 409, at p. 410.

[15] *People ex rel. Gorham Mfg. Co.* v. *State Tax Commission,* 197 App. Div. 852, involving leases continuing or renewable for 50-60 years.

[16] E.g., *Appeal of Newman Theatre Co.,* 4 B.T.A. 390 (three leases, all having unexpired terms over 95 years); *A. H. Woods Theatre Co.* v. *Commissioner,* 12 B.T.A. 827 (99-year lease); *Consolidated Investment Co.* v. *Commissioner,* 13 B.T.A. 1252 (90- and 99-year leases, valued as of two different dates); *Martha Realty Co.* v. *Commissioner,* 22 B.T.A. 342 (99-year lease, valued as of two different dates).

[17] E.g., in addition to the cases cited in note 16, *supra, Appeal of Northern Hotel Co.,* 3 B.T.A. 1099 (76-year unexpired term); *Steele Wedeles Co.* v. *Commissioner,* 11 B.T.A. 279 (80-year unexpired term); *L. S. Donaldson Co.* v. *Commissioner,* 12 B.T.A. 271 (four 73-year unexpired terms and four 95-year unexpired terms); *Hotel Wisconsin Realty Co.* v. *Commissioner,* 16 B.T.A. 334 (97-year unexpired term); *James Bldg. Co.* v. *Commissioner,* 22 B.T.A. 658 (three 98-year unexpired terms).

B. Eminent Domain Cases.

When leased property is taken for public use, the lessee as well as the lessor is entitled to be compensated for the loss of his interest. He is, therefore, required to establish by satisfactory proof that the lease has a definite value to him. Here, too, the courts have accepted as proper the valuation of long unexpired terms.

In the case of *In re Delancey Street,* 120 App. Div. 700, where a total term of 59 years including renewals was to be valued, the court said:

> "What is to be ascertained is the fair market value of the lease. Undoubtedly all the elements of a lease can be considered, and in addition the testimony of experts, who are to testify as to the market value of the lease, with the covenants, conditions and obligations imposed upon the landlord and the tenant, and it is this market value to which he is entitled." [18]

The valuation of a 47-year unexpired term, on three alternative constructions, was involved in *McIntosh* v. *The Pontypridd Improvements Co., Ltd.,* 61 L.J. Q.B. 164 (affirmed 8 T.L.R. 203, C.A.), and, upon settling the questions of law on which the alternatives depended, one of the valuations was approved by the High Court of Justice.

In *Bogg* v. *Midland Railway Company,* L.R. 4 Eq. 310, compensation for the loss of a 26-year residue was ascertained by valuation, and the Vice-Chancellor overruled a demurrer to a bill seeking additional compensation for a renewal term, which would extend the residue to an 82-year total.

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[18] 120 App. Div. at p. 708. At p. 705 the court said of this subject: "The fact that to ascertain such a value involved more or less difficulty is no reason why it should not be fairly met and determined."

The 30-year unexpired term of a 99-year lease was valued in *Morgan* v. *London and Northwestern Railway Co.*, [1896] 2 Q.B. 469.

The Supreme Court of Michigan, confining a lessee's compensation for loss of an unexpired term of 24 years to $280,000, the "value of the leasehold interest," said:

> "Where an entire leasehold interest is taken, it is a sensible and just rule that confines the damages to the fair market value of the lease, and, in case of exceptional circumstances where it has no market value, then the damages are the actual value. In estimating the value, it is proper to consider the location of the premises, their special adaptability to the business there being conducted, the length of time it has been established, its earnings and profits, the unexpired term of the lease, and every other fact that may affect its value. All of these matters go to enhance the value of the lease. They are not substantive elements of damages in condemnation proceedings."

In re Park Site, 247 Mich. 1, at p. 4.

C. Contract Cases

A situation closely similar to that created by disaffirmance of a lease under Section 77 is found when a contract to take, or give, a lease is broken. Damages are measured by the same rule; the right to their recovery makes such contracts enforceable. In these cases no suggestion appears that the courts will refuse full damages because of the length of a term.

A contract to give a 99-year lease was broken in the case of *Bondy* v. *Harvey*, 218 App. Div. 126, and damages were awarded on the basis of the difference between rental value and rent, although the case was sent back for failure

to deduct a proper discount. See also *A. J. Richey Corporation* v. *Garvey*, 132 Fla. 602.

In *Williams* v. *Burrell*, 1 C.B. 402, tenants holding under two leases limited to three lives or 99 years were evicted after 37 years of their terms had run, and they were held entitled to damages for the loss of the unexpired term. This presents the converse of the typical disaffirmance situation.[19]

The amendments to the Bankruptcy Act are too recent for many cases involving long-term leases to have reached appellate courts as yet, but it may be observed that this Court, in *Meadows* v. *Irving Trust Company*, 299 U.S. 464, expressly contemplated that under the former Section 77B proof of a claim for loss of a lease having an unexpired term of 89 years could be made (299 U.S. at pp. 466, 467). The fact that Section 77B set an outside limit of 3 years rent plus accruals did not alter the necessity of basing the proof upon the universal formula of rent reserved less rental value of the whole remaining term, for that must first be computed before the limitation can become operative, as is likewise true under every section of the Bankruptcy Act of 1938 where a limit on damages is established.[20]

The 969-year unexpired term in the case at bar has, of course, already been before this Court in *Connecticut Railway and Lighting Company* v. *Palmer*, and, although the difficulty of proving its value was emphasized, the possibility

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[19] See also *Leslie* v. *Crommelin*, Irish Rep. 2 Eq. 134, involving the difference between a life estate and a lease for three lives or 31 years.

[20] Bankruptcy Act of 1938, Sections 63(9), 202, 353, 458 and 642, 11 U.S.C. Sections 103(9), 602, 753, 858 and 1042. In *Urban Properties Co.* v. *Irving Trust Co.*, 74 F. (2d) 654 (C.C.A. 2), the value of a 25-year term was fixed for the purpose of a claim in bankruptcy (pp. 655, 666), but, since the Act had not as yet been amended, the claim was disallowed.

that satisfactory proof could be made was plainly recognized, for this Court remanded the case for further proceedings in the District Court, saying (305 U.S. at p. 503):

> "Notwithstanding its extended term, the lease created an obligation under the present Bankruptcy Act upon the New Haven entitled to share in its assets upon reorganization on an equality with the claims of other creditors."

The valuation of long-term leases is a relative commonplace in the business world. In the hundreds of instances of railroad leases, and the many thousands of cases where other properties have been leased for long terms, both parties have necessarily considered the subject in reaching an agreement. The elements of value which contribute to an informed business judgment on this question are the same as those which the courts have weighed in the numerous cases where the valuation of long-term leases has been the subject of judicial consideration. The element of discount, which makes reasonable business judgment possible in long-term matters, also facilitates a court's determination of value, for it renders the first few years of far greater importance than the later years, while the remote years of the term have little if any appreciable effect upon present values.

III. The Decision of the Circuit Court of Appeals.

The basis of the Circuit Court of Appeals' decision appears in this sentence:

> "In effect, the law for purposes of damages treats a lease with 969 more years to run as if it were only for a term within the reach of fairly definite forecast; the unpredictable stretch beyond is disregarded." (109 F. (2d) at p. 571.)